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IN THE

Supreme Court of the United States

October Term, 1956.

No. 717.

In the Matter of:
QUAKER CITY UNIFORM CO., INC., *Bankrupt.*

DANIEL P. VELORIC and FIDELITY-PHILADELPHIA TRUST COMPANY,
Petitioners,
and
COLLEGE HALL FASHIONS and SYNTHETIC SPECIALISTS, INC.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENTS IN OPPOSITION.

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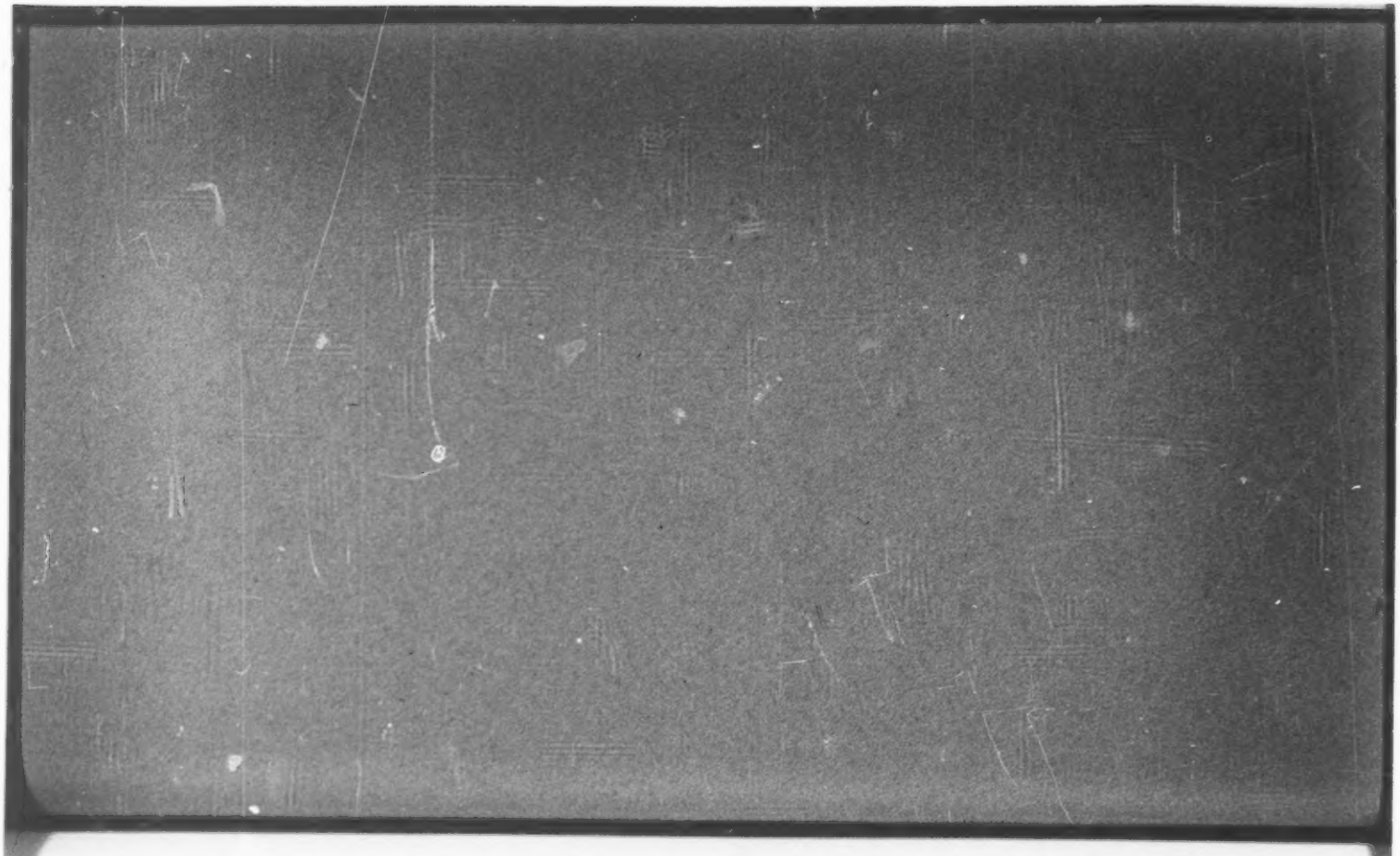

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BRIEF FOR RESPONDENTS IN OPPOSITION.

I. CITATIONS TO OPINIONS BELOW.

The citations to opinions below are as set forth in the petition for a writ of certiorari.

II. JURISDICTION.

Petitioners invoke the jurisdiction of this court under 28 U. S. C., Section 47c.

III. QUESTIONS PRESENTED.

1. Do chattel mortgagees acquire greater rights and priority of payment, as the result of the filing of a petition in bankruptcy, than the rights and priority of payment to which, it is conceded, they are entitled, under state law?

2. Where state law subordinates the lien of a chattel mortgage to the lien of a landlord's distraint, and where such law accords a priority of payment to wage claimants out of the fund arising from the distraint, are the wage claimants entitled to a priority of payment out of the fund realized from the sale of mortgaged chattels upon which the landlord has caused a distraint and levy to be made?

3. Where state law subordinates the lien of a chattel mortgage to the lien of a landlord's distraint, and also subordinates the lien of a landlord's distraint in that it accords priority of payment to wage claimants; and, in addition, under Section 67 (c) of the Chandler Act, the lien of a landlord's distraint is postponed in payment to both administration expenses and wage claims, are the wage claimants entitled to a priority in payment ahead of the landlord and

the chattel mortgagees, when a petition in bankruptcy is filed after a landlord has distrained for rent?

IV. STATUTES INVOLVED.

The statutory provisions involved are as set forth in the petition for a writ of certiorari, and in addition, Section 1 of the Act of Assembly (Pa.) of June 12, 1878, Public Law 207, 43 Purdon's Penna. Statutes 230; and Title and Section 1 of the Chattel Mortgage Act, Act of Assembly (Pa.) of June 1, 1945, Public Law 1358, 21 Purdon's Penna. Statutes 940.1, which Acts are printed in the appendix infra, pp. 15 and 16.

V. STATEMENT.

College Hall Fashions and Synthetic Specialists, Inc., respondents in this action, are the assignees of various wage claimants of Quaker City Uniform Co., Inc., bankrupt. By a stipulation of facts entered into by and between counsel for the receiver, counsel for the petitioners, counsel for the landlord, counsel for the Philadelphia Joint Board, Amalgamated Clothing Workers of America, and counsel for the respondents, it was stipulated and admitted, inter alia, that

> "18. Proof of claim for wages was filed by College Hall Fashions in the amount of $1,517.00, as assignees of a number of wage claims of persons employed by the Bankrupt, which wages were earned within three months of the filing of the petition in bankruptcy, and therefore entitled to priority as such.
>
> 19. Proof of claim for wages was filed by Synthetic Specialists, Inc., in the amount of $7,001.60, as assignee of a number of wage claims of persons employed by the Bankrupt, which wages were earned within three

months of the filing of the petition in bankruptcy, and therefore entitled to priority as such."

Prior to the filing of the petition in bankruptcy, the landlord made a distraint on all the goods of the bankrupt that were on the landlord's premises. The sale under the distraint and levy was stayed under Pennsylvania law because execution was issued by the Sheriff of Philadelphia on another judgment against the bankrupt. Thereafter, the bankruptcy petition was filed before the sheriff's sale was held. The validity of the landlord's distraint and levy is conceded by all of the parties.

By agreement between Veloric, one of the petitioners herein, and the receiver in bankruptcy, the property covered by the chattel mortgages was sold, and the fund realized therefrom was substituted for the mortgaged chattels. The landlord and Fidelity-Philadelphia Trust Company, the other petitioner, acquiesced in this agreement. The respondents were not parties to this agreement.

The proceeds from the receiver's sale of the goods upon all of which the landlord had made a distraint and levy amounted to $9896.77.

The rights and priorities of payment of the various claimants to the fund were then adjudicated by the referee in bankruptcy, United States District Court for the Eastern District of Pennsylvania, and twice by the United States Court of Appeals for the Third Circuit. On two occasions the United States Court of Appeals for the Third Circuit has held that the order of distribution of the funds in the trustee's hands should be: (1) administration expenses; (2) wage claimants; (3) landlord; and (4) chattel mortgagees. It is from this order of distribution that the petitioners pray that a writ of certiorari issue.

VI. ARGUMENT.

A. THE FILING OF A PETITION IN BANKRUPTCY DOES NOT CONFER RIGHTS UPON CHATTEL MORTGAGEES GREATER THAN THOSE CONFERRED UNDER STATE LAW; NOR DOES IT GIVE SUCH MORTGAGEES PRIORITY OF PAYMENT.

The rights, privileges and priority of payment afforded to chattel mortgagees are only those rights which are afforded to them under the applicable state law under which they hold their security. The lien created in favor of chattel mortgagees must arise under the state law. It is recognized in bankruptcy only to the extent of its recognition under the state law. The Bankruptcy Act does not create liens. It only recognizes and gives effect to certain liens which arise out of the state law.

Petitioners have contended throughout this matter that a chattel mortgage is a consensual or contractual lien for the sole reason that it arises out of a contract between the mortgagor and the mortgagee. While this may very well be true in those states which have recognized liens on chattels as part of their common law, it is not true in the State of Pennsylvania, which has consistently refused to recognize or give effect to consensual or contractual liens created on chattels under the common law. In Pennsylvania, chattel mortgages are statutory creations, having been created by the Act of Assembly of June 1, 1945, P. L. 1358, 21 Purdon's Penna. Statutes, 940.1.

The courts of Pennsylvania have consistently held that prior to the passage of the Chattel Mortgage Act, supra, "It had been the settled public policy of the law of this Commonwealth as manifested by legislative acts and judicial decisions, to frown upon the mortgaging of chattels in Pennsylvania"; *First National Bank of Jamestown v. Sheldon*, 161 Pa. Superior Ct. 265; *Roberts' and Pyne's Appeal*, 60 Pa. 400; *Klaus v. Majestic Apartment House Company*, 250 Pa.

194, 95 A. 451; *Kaufmann & Baer v. Monroe Motor Line*, 124 Pa. Superior Ct. 27, 187 A. 296.

Further, it has been repeatedly held under the Pennsylvania common law that it is essential to the validity of a pledge of personal property that either actual or constructive possession of the pledged property be delivered to the pledgees. *Ambler National Bank v. Maryland Credit Finance Co.*, 147 Pa. Superior Ct. 496, p. 502, 24 A. 2d 123.

Since the Chattel Mortgage Act is in derogation of the common law of Pennsylvania, it must be strictly construed, and the rights, duties and remedies of the parties to a chattel mortgage are only as specifically set forth in the statute and may not be inferred. Accordingly, the Pennsylvania courts have consistently held that the common law lien of the landlord is superior to the lien of the chattel mortgagee. Goods in the leased premises are subject to the landlord's distraint when the tenant is in arrears in rent, and it is immaterial that they are held by the tenant under a bailment lease, conditional sale or subject to a chattel mortgage. *Ferbro Trading Corp. v. Jo-Mar Dress Corp., et al.*, 78 Pa. District & County Reports, 337.

In *Commercial Credit Plan v. Mahoney, et al.*, 67 Pa. District & County Reports, 577, it was held that a landlord's distraint for unpaid rent is entitled to a priority over the claim of a chattel mortgagee, *even though the levy of the distraint was made subsequent to the recording of the chattel mortgage.* (Emphasis supplied.)

It has been generally true that the validity and effect of a security agreement are determined by the law of the state in which the chattel is located, at the time the agreement is executed. *In re Industrial Sapphire Manufacturing Co.*, 182 F. 2d 589; *Personal Finance Co. v. General Finance Co.*, 133 Pa. Superior Ct. 582, 3 A. 2d 174; *Restatement Conflict of Laws*, Sections 265, 272, 279.

The District Court and the Court of Appeals both recognized the superior right of the landlord over the chattel mortgagee. In his Opinion, Chief Judge Kirkpatrick stated:

> "If bankruptcy had not intervened, the controversy could hardly have arisen, because the law of Pennsylvania clearly subjects the interest of the chattel mortgage to the lien of the landlord's levy. The chattel mortgagee concedes as much but argues that the Bankruptcy Act nullifies the landlord's preferred status as against him." *In the Matter of Quaker City Uniform Co., Inc., Bankrupt*, 134 F. Supp. 596.

The Learned Chief Judge then fell into error by holding that while the landlord had a priority in the fund over the chattel mortgagees, the wage claimants were not entitled to prior distribution. This ignored the clear provisions of the Pennsylvania law, as well as the provisions of the Bankruptcy Act granting wage claimants priority over rent claims.

The Court of Appeals, in this case, held that except in certain situations, where federal law has spoken, priority among liens is determined by the law of the state, citing *Seymour v. Wildgen*, 137 F. 2d 160; 4 Collier on Bankruptcy, 296, 1347 (14th ed.). The court then held that by settled Pennsylvania law the landlord's lien by way of distraint takes precedence over a chattel mortgage, when the chattel mortgagee has failed to obtain a landlord's waiver. It was the opinion of the court that the interpretation requested by the chattel mortgagees would ascribe to Congress the intent that a chattel mortgagee should benefit from the event of bankruptcy, before which his lien was inferior to the landlord, and after which it became the superior lien. As the court pointed out, this proposition contains the undesirable feature of needlessly upsetting state lien priority rules.

B. THE DECISION BELOW IS CORRECT, AND DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT OR ANY OTHER COURT.

The Court of Appeals concluded that since the Bankruptcy Act does not establish a system of liens, but merely gives effect to the relative standing of liens under applicable state law, it must necessarily follow that under the Pennsylvania law, the lien of the landlord on distraint, is superior to the lien of the chattel mortgagees. The court then applied the clear language of the Chandler Act of 1938, which introduced Section 67, sub. c, 11 U. S. C. A. Section 107, sub. c, the pertinent provisions of which read:

> "c. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act * * * (1) though valid against the trustee under sub-division (b) of this section, statutory liens * * * on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision (a) of section 64 of this Act * * *."

The expenses of administration and wage claims, while ordinarily merely unsecured claims given first and second priority as such under Section 64, sub. a, became payable before the lien of the landlord under the specific language quoted above.

The holding of the Court of Appeals is clearly correct under the factual situation in this case. When a Pennsylvania landlord has distrained for rent, and acquired a superior lien over chattel mortgagees, and thereafter bankruptcy intervenes before the sale under the distraint, he is subject to the provisions of the Bankruptcy Act postponing his lien to the payment of administration expenses and wage claims. In such a situation, he may not be paid until after the administration expenses and wage claims are paid to the ex-

tent that they have priority under Section 64 of the Bankruptcy Act. Thereafter, the landlord's claim is to be paid to the extent that he had acquired a lien under applicable Pennsylvania law, and only then may the chattel mortgagees be preferred over other secured and unsecured creditors.

The priority of payment accorded to the wage claimants over the landlord under the Bankruptcy Act, is likewise accorded the wage claimants under Pennsylvania law. The Act of Assembly of June 12, 1878, P. L. 207, Section 1, 43 P. S. 230, provides:

> "It is the true intent and meaning of the provisions of the Act of Assembly, entitled 'An act for the better protection of the wages of mechanics, miners, laborers and others,' passed the 9th day of April, 1872, that the several classes of laborers in said act mentioned shall have a preference over landlords, in all claims for rent * * * where the lessee or lessees are the parties employing the miners, mechanics, laborers or clerks: Provided That any person or persons claiming a preference as above provided, shall give notice of the nature and the amount of his claim to the landlord or his bailiff, before the actual sale of the property levied upon."

Thus, it can be seen that both under the Bankruptcy Act and the applicable Pennsylvania law, the wage claimants have a priority of payment over the landlord.

The decision of the court of appeals does not presume to decide the effect of chattel mortgages in jurisdictions other than Pennsylvania, and in factual situations different from the case at bar. Its decision is manifestly correct under the facts and the law in this case.

Petitioners urge that the instant case conflicts in principle with the decision of the United States Circuit Court of Appeals for the Fifth Circuit, in *City of New Orleans v. Harrell*, 134 F. 2d 399. That case is readily distinguishable from the case at bar. In that case the court held that a tax

lien, which the City of New Orleans claimed was a superior lien, was ineffectual because it had not been properly perfected. The court there reached the conclusion that the City's claim for unpaid taxes was a statutory lien within the meaning of the Bankruptcy Act, and that since it was not accompanied by possession it did not take precedence over a chattel mortgage which had been recorded prior thereto. In the instant case, the landlord's lien had been perfected by the distraint and levy for rent, and his lien was superior to the lien of the chattel mortgagees.

C. THE DECISION BELOW RAISES NO IMPORTANT QUESTION OF FEDERAL LAW.

The Petitioners do not seriously urge that an important question of federal law has been raised by the decision in this case. Instead, they assign as reasons for granting the petition for a writ of certiorari that the issue is of tremendous importance both legally and economically; that the adverse effect of the lower court's decision is critical; and that the decision defeats the purpose of the Bankruptcy Act and the intention of Congress. An examination of these reasons will reveal that they are basically without merit, and that they do not afford any compelling reason why certiorari should be granted. The instant case has decided an issue of fact and law arising under the peculiar facts of this case, and the application of the Pennsylvania law with respect to the relative priority of liens between a landlord and a chattel mortgagee. Security transactions under the Uniform Commercial Code are not at all affected by the decision of the court of appeals. The chattel mortgages here in question arose before the adoption of the Uniform Commercial Code, and were given pursuant to the provisions of the Pennsylvania Chattel Mortgage Act, supra. Every lender who took a chattel mortgage under the Pennsylvania Chattel Mortgage Act knew that in order to have a lien on the

chattels which would be superior to a landlord's lien in the event of a distraint for rent, it must first obtain a landlord's waiver of the landlord's right to distrain on the mortgaged chattels. The Petitioners in this action failed to obtain such a waiver. It is inconceivable that they were unaware of this requirement of the Pennsylvania law. It is suggested that the real reason for not obtaining the landlord's waiver was the refusal of the landlord to execute such a waiver. The petitioners therefore assumed the risk of having their security impaired if the landlord distrained for rent.

The briefs filed in the court below by the amici curiae on behalf of certain banks, and the National Commercial Finance Conference, Inc. concerned themselves with the first opinion of the court of appeals, which held that in Pennsylvania a chattel mortgage was a "statutory lien" within the meaning of the Bankruptcy Act. This holding of the court of appeals has been cured by its action in withdrawing its first opinion, and writing a second opinion, which, although it reached the same conclusion as to priority of distribution of the funds, held,

> "It is not necessary to decide whether or not a Pennsylvania chattel mortgage is a 'statutory lien' within the meaning of Section 67, sub. c * * *. For the purposes of this opinion, however, we shall assume that it is not a 'statutory lien' within the purview of Section 67. * * *"

The amici curiae have thus accomplished their purpose. We are not here concerned with the law of other states, insofar as it relates to the priority of liens as between landlords and chattel mortgagees. In Pennsylvania, a chattel mortgagee can assure its superiority over the landlord, and thereby avoid the problem presented by the instant case by the simple expedient of being selective in its lending, and insisting upon obtaining a landlord's waiver of his right to distrain on mortgaged chattels.

The petitioners also argue that the holding of the court

below has already been extended in a Referee's unreported opinion in the matter of in *re George Townsend Co., Inc.* (reprinted in petitioners' appendix, p. 47). Petitioners admit that the facts in that case are substantially different from the facts in the case at bar. There, the landlord had *not* distrained and therefore had not perfected his lien on the goods pledged under the chattel mortgage and conditional sale. Petitioners state, "The Referee felt that the instant case compelled the result that under state law the landlord's claim, though not a lien, was entitled to priority over the security interests," and ordered distribution accordingly. It is obvious that if the landlord's claim was not, in effect, a lien superior to the lien of the security interests, then the decision in the case at bar does not apply. A reading of the referee's opinion discloses that he was inconsistent in his reasoning and decision. At page 48 of petitioners' appendix the referee says:

> "(2) Does the fact that the landlord did not distrain before bankruptcy in this case, change the order of distribution as promulgated in the Quaker City case, where there was such a distraint? I think it does. * * *"

The referee then proceeds to enter an order inconsistent with his own reasoning. If the Referee in the *Townsend* case was in error, the remedy lies in correcting that error and not in upsetting the clearly correct decision of the court of appeals in the instant case.

The petitioners' final argument for the granting of a writ of certiorari is that the decision in the instant case defeats the purpose of the Bankruptcy Act and the intention of Congress. Quite the contrary is true. The intention of Congress, as clearly expressed in the Bankruptcy Act, is to accord administration expenses and wage claimants a priority of payment over the landlord, whether the lien arising from the distraint for rent is statutory or not. The Congress, in its wisdom, has seen fit to grant priority to administration expenses and wage claimants over the landlord, in spite of

any state law to the contrary. The court of appeals in this case has given effect to the clear mandate of the Congress by holding that administration expenses and the wage claimants are to be paid before the landlord is paid. The petitioners' real position is that although they have failed to properly protect themselves in accordance with the established law of Pennsylvania, the state wherein their lien arises, by not obtaining a landlord's waiver of his right to distrain on the mortgaged chattels, this court, for extraneous reasons not connected with the issue herein presented, should issue a writ of certiorari, and thereby advance their interests. It is obvious that such a result is unwarranted.

VII. CONCLUSION.

The petitioners have conceded throughout this case, before the referee, before the district court, before the court of appeals, and even before this court, that under the law of Pennsylvania the landlord's lien is superior to their lien. On Page 13 of their petition, they state:

> "It is manifestly clear from a reading of the Bankruptcy Act that contractual or consensual liens *valid* under state law were to be so recognized and treated in the administration of a bankrupt's estate". (Emphasis supplied.)

This is the crux of the matter. What they have failed to say, however, is that the priority of the valid liens is established by the state law. Since they have conceded that under the state law their lien is subordinate to the landlord's lien, it becomes increasingly obvious that the decision of the court of appeals is correct. The Bankruptcy Act specifically postpones payment of the landlord's lien to payment of administration expenses and wage claims. The real position of the petitioners is that the mere act of bankruptcy has defeated the priority of liens established by the state law, even though the state law is the basis for their lien. The

court of appeals rightfully rejected this contention. The Congress did not intend, nor does the Bankruptcy Act provide that a petition in bankruptcy should create a superior lien where there was none under the state law before the petition was filed.

For the reasons herein set forth, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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VIII. APPENDIX.

Section 1. Act of Assembly (Pa.), June 12, 1878, (43 Purdon's Penna. Statutes 230).

It is the true intent and meaning of the provisions of the act of assembly, entitled "An act for the better protection of the wages of mechanics, miners, laborers and other," passed the ninth day of April, 1872, that the several classes of laborers in said act mentioned shall have a preference over landlords, in all claims for rent of any mines, manufactories or other real estate, held under lease, where the lessee or lessees are the parties employing the miners, mechanics, laborers or clerks: Provided, That any person or persons claiming a preference as above provided, shall give notice of the nature and amount of his claim to the landlord or his bailiff, before the actual sale of the property levied upon.

Title and Section 1 of the Pennsylvania Chattel Mortgage Act, (21 Purdon's Penna. Statutes 940.1 et seq.).

Relating to chattel mortgages on any chattel or chattels of any kind or description, including, but not limited to, livestock, poultry, farm machinery, farm equipment and crops, grown, growing or to be grown; designating the operation and effect of the lien of such mortgages; providing for the filing, indexing and docketing of such mortgages and related instruments in prothonotaries' offices; and prescribing prothonotaries' fees; providing for the filing in Pennsylvania of similar lien instruments originally filed or recorded in other states; regulating the assignment, release, satisfaction and extension of the lien of such mortgages; prescribing methods of foreclosure; defining defaults and violations; and fixing penalties.

Section 1. Any person, association, partnership or corporation *may* give as security for any funds borrowed or to be borrowed or any pre-existing indebtedenss, a bond or note, with or without a confession of judgment clause, secured by a chattel mortgage upon any chattel or chattels of any kind or description, including, but not limited to, livestock, poultry, farm machinery, farm equipment and crops, including annual or perennial crops, and other plant products, either grown or growing at the time of the execution of such chattel mortgage, or to be planted or grown within one year thereafter. For the purposes of this act all such chattels and crops shall be deemed to be personal property and mortgageable as such. The indebtedness secured by any such chattel mortgage shall not bear interest in excess of the rate which the creditor is permitted by law to charge at the time of the execution of such mortgage. (Emphasis supplied.) (Repealed by the Uniform Commercial Code—Secured Transactions, Act of Assembly (Pa.) of April 6, 1953, Public Law 3, 12A Purdon's Penna. Statutes, Section 10-102.)